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THE MAGAZINE FOR GROWING COMPANIES

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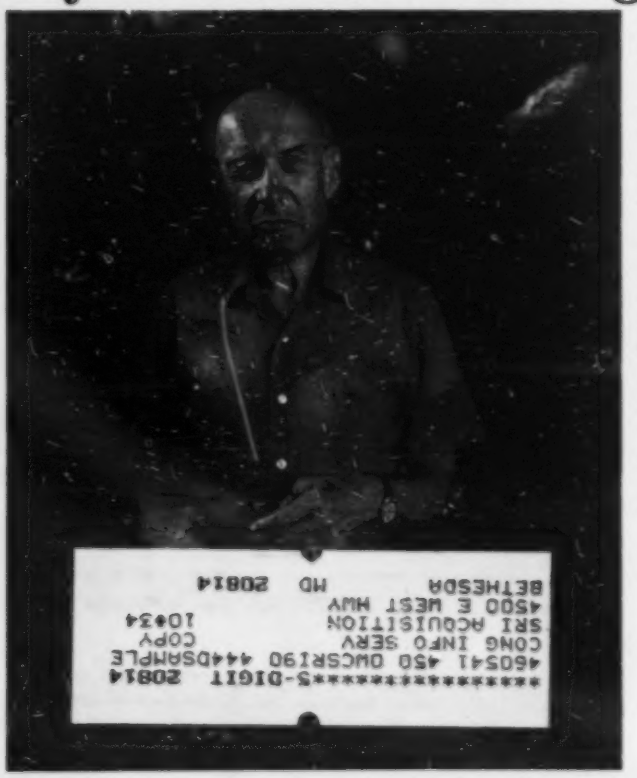
REPORT ON THE STATES
A NEW FEATURE: America's Best-Managed Companies

THE ENTREPRENEURIAL MYSTIQUE

Most of what you hear about entrepreneurship, says America's leading management thinker, is all wrong. It's not magic; it's not mysterious; and it has nothing to do with genes. It's a discipline and, like any discipline, it can be learned.

An Interview with
Peter Drucker



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Cover photo
Patricia Barry Levy

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CORPORATE SPIES

Computers Vulnerable in Small Companies

ONCE UPON A TIME, ONLY BIG companies had to worry about computer crime. But times change.

Small companies are increasingly vulnerable to computer criminals, ranging from hackers on an electronic joyride to competitors stealing data. "Small companies are often pushovers," says August Bequai, a Washington, D.C., lawyer specializing in industrial security. "They're concerned with growth and cash flow. They don't understand computer security and don't have money to implement it. They become prime targets."

Spies and hackers gain access to computers through telephone lines linking the computers to the outside world; employees on the road or at home use these lines to connect their terminals to the main computer. But criminals can dial the same lines, then manipulate the password system to gain entry—often a simple task if employees use predictable passwords. Companies are also vulnerable if they buy used computers that lack state-of-the-art security features.

Many computer crimes go unreported, since small companies can't afford the adverse publicity, cost of litigation, or insurance increases that can come with such cases. "Small businesses do everything they can to hide their vulnerability," says Donn Parker, a senior management consultant with SRI International. "It's much easier to simply forget it."

The criminal code isn't much help. Congress has failed to adopt a statute that covers private-sector computer crime. More than 30 states have passed such laws, but only about 60 cases covered by these statutes have reached the courts. —*William Souder*

JOHN NEUBAUER

Lawyer August Bequai says small firms are prime targets of computer crime.

Gum chewers owe their treat to the Mexican general who wiped out Davy Crockett and his band at the Alamo. General Antonio López de Santa Anna, a deposed dictator living in exile on Staten Island, figured he could raise enough money for an army if he started an artificial-rubber industry based on chicle. In 1869, he gave New York inventor Thomas Adams Sr. a chicle sample and persuaded him to buy another ton for experiments. When Adams didn't produce anything, Santa Anna lost interest. Adams didn't. He eventually used the chicle to create a chewing gum that was better than the awful paraffin wax then available. The first batch of 200 unflavored gum balls sold out before noon the very first day—to Jersey City schoolchildren, who no doubt spent the afternoon writing, "I will not chew gum in class."

SCORECARD

Small-Time Justice

The mergers game has become the greatest show on Wall Street, with huge companies gobbling each other up with nary a protest from the trustbusters in Washington. But the total number of antitrust cases has dropped only slightly since President Reagan took office. The vast majority of antitrust cases now, as in the past, are brought against small or medium-size companies.

These defendants make easy targets, because they have neither the money nor the management depth to defend a case for years. And most are charged with bid rigging and price fixing, allegations that are comparatively easy to prove. The prosecution just has to establish that conspiracy for the purpose or effect of restraining competition did in fact take place. On the other hand, monopolization or restraint-of-trade cases against large companies are so complicated that they can consume a decade or more of litigation—witness the mammoth cases against American Telephone & Telegraph Co. and IBM Corp.

FRANK SITEMAN/THE PICTURE CUBE

Small government contractors, especially those involved in road work and other construction, were the most common antitrust defendants in both 1980 and 1984, the fourth years of the Carter and Reagan Administrations. Professional associations were a hot target in 1980 because of alleged restrictions on membership or pricing, practices that can make it more difficult for entrepreneurs to enter a market. Here are the top 11 antitrust targets: —*Virginia Inman*

Rank	1980 Industry	1980 # cases	Rank	1984 Industry	1984 # cases
1.	Road building	34	1.	Road building	45
2.	Elect. construction	20	2.	Professional services	11
3.	Paving material	12	3.	Construction	6
4.	Utility construction	3	4.	Concrete construction	4
5.	Waste disposal	3	5.	Asphalt/paving	4
6.	Aerial spraying	3	6.	Steno reporting	4
7.	Retail gasoline	2	7.	Milk/dairy products	3
8.	Scrap metal	2	8.	Chemicals	3
9.	Supermarkets	2	9.	Airport construction	2
10.	(none with more than 1)		10.	Home food processors	2
11.	(none with more than 1)		11.	Screws	2
	Total # cases: 100			Total # cases: 115	

SOURCE: COMMERCE CLEARING HOUSE INC./TRADE REGULATION REPORTS

INC.'S FIFTH ANNUAL

REPORT ON THE STATES

BY NELL MARGOLIS

Ever since INC. first started doing the annual Report on the States in 1981, our purpose has been less to rank the 50 states than to aid businesspeople and policymakers in their ongoing efforts to improve the climate for small businesses. And, increasingly, each successive States Report, based on information drawn from federal government data and telephone interviews with state officials, becomes the profile of a nation mobilizing to face that challenge. This year's total scores are an all-time high.

Leading the pack, with 86.4 points (out of a possible 100), is California, which met the challenge head-on with creative and innovative small-business support systems of every kind. And yet the term "winner" also applies to 50th place West Virginia, with a score of 42.1, which allocated a portion of its relatively scant resources toward a new loan-guarantee program for small businesses, and which ranks among the high performers in state support. And some mention must go to South Carolina, which continued last year's record-breaking 31-place climb by moving an additional 5 places this year to #14. The higher scores all across the board reflect the continuing (if uneven) national economic recovery, a condition over which states have little control. But another factor has contributed to a more agreeable climate for small, growing businesses—every single state now has at least 1 of the 10 small-business support and capital-availability programs that INC. surveys.

There are few surprises among the overall top-ranking performers. California, which leads the capital category for the third consecutive year and now joins the top scorers in state support as well, moves up to #1 from its 1984 stop at #3. In fact, last year's top three states—Connecticut, Massachusetts, and California—are still hanging together around the top, albeit in slightly scrambled order, and are joined by Colorado, which moves up to #3, largely on the strength of its new state-support programs. Only Florida, which jumps 19 places to reclaim the #6 position it held two years ago, can be described as having made a leap into the top 10. Its rise is due to a number of factors: its improvements in state support, capital, and particularly in general business activity.

While it would be *interesting* to report that a given geographical region had either captured or abdicated the top sector of our ranking, it wouldn't be *true*. This year's top 10 states represent seven different regions—East Coast, West Coast, Gulf Coast, New England, Middle Atlantic, Midwest, and Rocky Mountain.

The biggest shifts from the 1984 to the 1985 rankings occur not at the top, but at the bottom. Although Utah scored below the median in the capital category, steady improvement across the board allowed it to climb from #45 in 1984 to #19 in 1985. Roughly the same number of steps gained by Utah were lost by Nebraska—and one needn't search hard to find where the shortfall occurred, or why. If there was any money to be made in farming last year, only the motion picture industry found it. Other states that fell in the overall rankings, hurt by cuts in capital and state-support programs, include Pennsylvania, Michigan, and Louisiana. Pennsylvania and Michigan were hit by declines in basic manufacturing industries, while Louisiana was strapped by drops in oil-related activities.

Capital plays an important role in the ranking (with a maximum of 25 points) because—as Cyndi Lauper so aptly put it—"money changes everything." This year, the top 10 states in capital resources are California, Connecticut, Massachusetts, Minnesota, Colorado, New York, Virginia, Alaska, Texas, and Illinois. The category measures levels of industrial and commercial lending, small business investment company (SBIC) activity, and four types of state capital-resources programs (direct loan, loan guarantee, bond guarantee, and venture capital funds).

After last year's blizzard of activity, with 24 states launching a total of 31 new capital-resource programs, this year's report would almost have to look tame by comparison—and it does. Eleven states added an aggregate of 15 new programs, 7 of which were venture capital funds; 13 states dropped a total of 16 programs, which would seem to be a slight setback. Here, however, the numbers can be deceiving. In a year of shrinking resources, the cancellation of a capital-availability program can signify healthy experimentation, a good-faith effort to allocate limited funds for maximum effect. Witness Utah's discontinuation of its direct-loan program and Georgia's dropping of a bond guarantee, with simultaneous inaugurations of venture capital funds in both states. Impressive commitments to improving the small-business economic environment show up in other states as well. Wyoming, despite its relatively depleted coffers, added a new program this year; Arkansas, its banked resources in not much better shape, added 2; and Indiana, notwithstanding low scores on dollars available at the banks of the Wabash, continues to offer all 4 types of state-provided capital programs.

Like capital, state-support activities are also important in the ranking (25 points), because the ways in which a state does or doesn't get behind its entrepreneurial sector are largely within the state's control and are often paramount in attracting, encouraging, and retaining INC.-size businesses. Scores are based on the presence or absence of a small-business advisory office (within state government), advisory council (comprised of small-business people), ombudsman, legislative committee, statewide conference, and procurement set-asides.

The top 10 states in this year's state-support category are Indiana, New York, California, Illinois, Kentucky, Georgia, Massachusetts, Connecticut, Minnesota, and Florida. It isn't difficult to understand why such 1984 top 10 states as oil-soaked Louisiana, or heavily industrial Michigan, Pennsylvania, and Ohio have each dropped at least one state-support program

Decisions made by state officials play a major role in determining the climate for small businesses. Capitols pictured are (row 1) California, Colorado, Minnesota; (row 2) Illinois, Utah, Washington; (row 3) Pennsylvania, Vermont, Iowa.

RATING THE STATES

Rank/state	CAPITAL RESOURCES				LABOR				TAXES
	Bank loans % assets	Comm./Ind. loans per capita	SBIC finan. per capita	State programs[1]	Avg. wkly. wage	% union	% h.s. grads. over 25	Value added per worker ($000/yr.)	Per $1,000 personal income
Median	57.5%	$947	$1.2		$380.4	23%	68%	$37.8	$106
1. California	69.1%	$1,903	$3.7	DL,LG,BG,VC	$410.2	27%	74%	$39.0	$108
2. Connecticut	62.3	1,705	6.4	DL,LG,BG,VC	404.0	23	71	37.4	104
3. Colorado	60.1	830	2.8	DL,LG,BG,VC	388.6	18	78	34.3	98
4. Massachusetts	59.0	2,087	4.8	DL,LG,BG,VC	357.7	25	73	33.6	118
5. Virginia	65.4	1,007	1.2	LG,BG	339.1	15	63	35.8	100
6. Florida	57.0	816	1.5	—	325.7	12	67	29.1	90
7. Minnesota	59.3	1,673	3.7	DL,BG,VC	403.3	26	72	37.8	132
8. New Jersey	57.8	1,190	1.8	DL,LG,BG	402.0	26	68	41.1	112
9. New York	55.1	5,173	5.1	DL,BG	384.2	39	66	43.6	153
10. Illinois	57.9	2,406	0.7	DL,LG,BG,VC	402.7	30	65	52.1	104
11. Indiana	54.3	835	1.2	DL,LG,BG,VC	449.9	30	66	43.5	90
12. Georgia	57.7	884	1.2	VC	329.4	15	57	30.2	103
13. North Carolina	59.3	1,124	1.1	VC	287.4	10	55	30.2	102
14. South Carolina	54.0	459	1.8	DL,LG,BG	306.1	8	54	29.4	105
15. Arizona	65.6	1,299	0.6	—	377.8	16	72	29.8	108
16. Delaware	81.3	6,866	0.5	—	423.0	25	68	34.2	109
17. New Mexico	57.3	792	1.6	DL,LG	349.6	19	68	29.0	117
18. Texas	61.3	2,435	4.7	—	386.4	11	61	46.9	93
19. Utah	59.1	864	1.2	VC	365.5	18	80	35.6	113
20. Hawaii	63.3	1,167	0.2	DL	310.1	28	73	59.8	129
21. Washington	66.8	1,328	1.1	—	448.5	34	77	49.2	114
22. New Hampshire	64.0	533	2.1	LG	336.5	16	72	28.4	89
23. Kansas	52.5	559	0.7	VC	378.8	15	72	42.3	97
24. Montana	55.7	705	2.9	LG,VC	432.3	29	75	62.1	126
25. Ohio	57.0	982	0.9	DL,LG,BG,VC	483.1	31	67	44.4	103
26. South Dakota	77.8	942	0.6	—	318.7	15	69	33.9	96
27. Rhode Island	57.3	1,620	1.9	LG,BG	287.5	28	61	29.4	120
28. Idaho	63.2	1,136	0.1	—	346.1	18	73	35.5	99
29. Louisiana	54.7	1,106	1.3	DL,LG,VC	426.6	16	58	70.0	105
30. Arkansas	52.9	696	0.8	DL,LG,BG,VC	301.2	16	55	29.7	92
31. Wisconsin	57.2	697	1.9	DL,LG,BG,VC	426.5	29	70	41.3	132
32. Vermont	70.6	926	0.4	DL,LG	344.9	18	71	34.3	122
33. North Dakota	51.6	576	0	LG,BG,	307.3	17	67	36.2	103
34. Maine	60.7	572	1.3	DL,LG,BG,VC	340.7	24	69	33.0	121
35. Alaska	62.1	1,694	1.6	DL,LG	449.4	34	83	80.8	330
36. Kentucky	52.5	815	0.5	DL,LG,BG	379.6	24	52	45.7	101
37. Alabama	51.2	725	1.9	DL	343.6	22	57	32.5	94
38. Iowa	49.7	474	0	DL,VC	419.0	22	71	55.2	109
39. Pennsylvania	59.8	1,749	0.4	DL,LG,VC	381.2	35	65	42.4	107
40. Michigan	57.8	1,126	1.6	VC	562.5	37	68	38.0	125
41. Missouri	52.5	835	0.2	DL,LG,BG,VC	394.8	28	64	37.8	92
42. Mississippi	50.8	581	2.0	DL	292.3	16	55	31.8	100
43. Oklahoma	55.2	1,280	1.6	DL	404.9	15	67	41.9	103
44. Nevada	56.7	952	0.8	—	381.9	24	76	31.4	103
45. Maryland	56.1	982	1.0	DL,LG,BG	404.6	23	67	43.1	111
46. Tennessee	54.2	836	0.8	—	339.9	19	55	32.5	91
47. Oregon	60.9	1,139	1.7	DL	421.1	26	75	40.6	119
48. Wyoming	51.8	613	1.9	LG	356.8	19	78	70.8	202
49. Nebraska	55.2	509	1.5	—	356.9	18	74	43.6	108
50. West Virginia	48.0	311	0.0	DL,LG	405.8	34	57	53.7	112

Sources (by column, left to right): Federal Deposit Insurance Corp. (1); Data Resources Inc. (2); U.S. Small Business Administration (3); State development agencies (4); U.S. Department of Labor, Bureau of Labor Statistics (5,6); U.S. Department of Education (7); Department of Commerce, Bureau of Census (8); Tax Foundation (9); INC. survey of 50 states (10); Department of Commerce, Bureau of the Census (11); Department of Commerce, Bureau of Labor Statistics (12); Department of Commerce, Bureau of Economic Analysis (13); Department of Commerce, Bureau of the Census (14); INC. (15)

STATE SUPPORT	BUSINESS ACTIVITY				
Small bus. assistance[2]	Pop. % change (1980-84)	Employmt. % gain (1982-84)	Pers. Inc. % change (1981-83)	Business units per 1,000 pop.	INC.100 companies (1979-85)
	3.1%	3.3%	16.3%	20	3
AO,OM,AC,LC,SC,PS	8.3%	5.7%	17.9%	21	97
AO,OM,AC,LC,PS	1.5	6.0	18.3	22	11
AO,OM,AC,SC,PS	10.0	6.9	16.2	23	26
AO,OM,AC,LC,PS	1.1	6.9	19.6	21	22
AO,OM,AC,LC,SC	5.4	7.6	17.9	18	8
AO,OM,LC,SC,PS	12.6	12.6	20.5	21	13
AO,OM,AC,LC,PS	2.1	3.6	18.0	21	27
AO,OM,AC,SC,PS	2.0	7.7	18.1	21	26
AO,OM,AC,LC,SC,PS	1.0	3.7	16.6	21	49
AO,OM,AC,LC,SC,PS	0.7	-2.0	14.7	19	5
AO,OM,AC,LC,SC,PS	0.1	0.8	17.7	18	9
AO,OM,AC,LC,PS	6.8	11.8	22.5	18	10
AO,OM,AC,LC,SC	4.8	7.1	20.4	18	2
AO,OM,AC,LC,SC	5.7	6.2	19.7	17	3
AO,OM,AC,LC	12.3	13.5	22.1	19	3
AO,OM,AC,LC,SC	3.1	8.3	16.9	20	1
AO,OM,AC,SC,PS	9.3	5.8	15.7	19	2
AO,PS	12.4	4.1	15.8	20	52
AO,AC,LC,SC	13.0	7.8	17.2	17	2
AO,OM,AC,LC,SC	7.7	1.9	14.7	21	0
AO,AC,LC,PS	5.2	1.8	10.8	21	9
OM,LC	6.1	11.6	21.1	22	2
AO,OM,AC,SC,PS	3.1	1.1	14.8	23	2
AO,OM,AC,LC,SC	4.7	-0.3	8.8	25	0
AO,OM,AC,LC,SC	-0.4	-1.6	15.3	18	9
AC,SC,PS	2.2	3.6	19.9	23	0
AO,OM,AC,LC	1.6	2.7	17.5	22	0
AO,OM,AC,LC	6.0	-0.7	15.7	20	1
AO,OM,SC,PS	6.1	-2.1	9.9	18	2
AO,OM,PS	2.7	5.7	17.4	18	0
AO,OM,AC,PS	1.3	0.9	14.7	20	4
AO,OM,AC	3.6	5.1	14.5	25	0
AO,AC,LC,SC,	5.2	1.3	17.1	24	0
AO,OM,AC	2.8	6.3	17.1	20	1
AO,OM	24.4	20.9	14.4	21	1
AO,OM,AC,LC,PS	1.7	0.8	15.0	17	2
AO,AC,LC,PS	2.5	2.7	16.4	16	3
AO,OM,AC,LC,SC	-0.1	-2.4	13.8	23	2
AO,OM,AC,SC	0.3	-1.7	13.0	18	8
AO,OM,AC,SC,PS	-2.0	-0.6	15.9	17	8
AO,OM,SC	1.9	3.0	17.4	20	1
AO,OM,AC,SC	3.1	0.5	15.2	16	1
—	9.0	-1.4	8.3	21	10
AO,AC	13.8	3.9	15.5	21	1
AO,PS	3.1	5.0	17.2	18	10
AO,OM,PS	2.7	3.0	16.9	18	4
AC	1.6	-1.4	14.2	22	4
OM	8.9	-11.0	4.0	27	3
AO	2.3	0.9	14.0	23	3
AO,OM,AC,LC,SC	0.1	-5.3	9.3	16	0

[1] DL-direct loans; LG-loan guarantees; BG-bond guarantees; VC-venture capital
[2] AO-advisory office; OM-ombudsman; AC-advisory council; LC-legislative committee SC-statewide conference; PS-procurement set-asides
* Includes union membership in District of Columbia

over the past year—if the spirit is willing but the cash is weak, state program cutting may be unavoidable. Nor did steps backward occur only in the top 10. Out of 13 states offering all six of the surveyed programs last year, only Indiana, New York, and Illinois have kept up the good work.

The labor ranking (20 points) weighs what a state "gets" in terms of productivity (dollar amount added by each employee to the raw value of manufactured goods) and a more sophisticated work force (percent of workers older than 25 who are high school graduates) against what it "pays" in terms of higher wages and extent of unionization.

The top 10 states this year are repeaters from last year, with only a few changes in order: Wyoming, Utah, Nebraska, Hawaii, Kansas, Colorado, Idaho, Vermont, South Dakota, and North Dakota. Wyoming, 48th in the general ranking, once again is in the lead.

As for business activity (20 points)—measured by changes in population, employment, and personal income; business unit density; and representation of INC. 100 companies—the top 10 states are New Hampshire, Florida, California, Colorado, Arizona, Massachusetts, Alaska, Georgia, Connecticut, and New Jersey.

The wild fluctuation that characterized this category last year is absent from this year's survey, which shows only one state—New York—departing the upper reaches. Despite increases in population and employment, a relatively slow growth rate in personal income broke New York's tenuous hold on top-10 status. Growth in employment and sharply increasing personal income sent Arizona back to the top, a recovery from last year's poor performance in this category.

Taxes count the least in our ranking (10 points), since low taxes don't necessarily coincide with, much less dictate, the most favorable soil for growing a business. "Tax advantages," as an eminent Boston corporate tax attorney once cautioned an audience, "are always the cherry on the sundae; they should never be the sundae itself."

The tax category is a case of opposites: The fewer taxes a state imposes, the higher its score. By that measure, the top 10 states are New Hampshire, Florida, Indiana, Tennessee, Missouri, Arkansas, Texas, Alabama, South Dakota, and Kansas. Of these, the only overall top-10 entry is Florida—which held the same #2 slot in taxes last year, when its overall position was #25. Moreover, two states—Missouri and Tennessee—are in the top 10 in the tax category rank, but in the bottom 20% overall. Another two states—Minnesota and New York—are in the top-10 rank overall, but in the bottom 10% in taxes. □